

SECURITY CONNECTED.

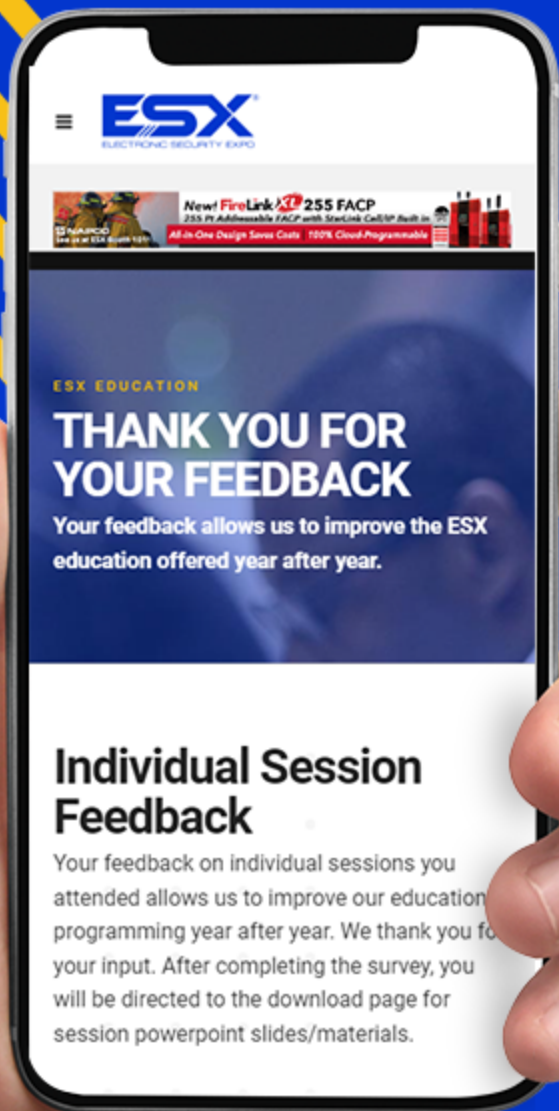


ELECTRONIC SECURITY EXPO

MANAGEMENT TRACK

**UNDERSTANDING RECURRING REVENUE
FINANCING IN TODAY'S CLIMATE**

ESX FEEDBACK



1

**ANSWER 5
QUESTIONS
ABOUT THIS
SESSION**

2

**GAIN
ACCESS
TO THE PPT
SLIDES**

3

**BE ENTERED
TO WIN A
\$100 GIFT
CARD**

3 GIFT CARDS (\$100 EACH) AVAILABLE FOR SURVEY RESPONDENT RAFFLES

WINNERS WILL BE NOTIFIED THROUGH THE ESX APP



**THE ELECTRONIC
SECURITY EXPO IS
OWNED BY:**

ESA ELECTRONIC
SECURITY
ASSOCIATION®

ELECTRONIC SECURITY EXPO. SECURITY CONNECTED. ELECTRONIC SECURITY EXPO. SECURITY CONNECTED.



NAPCO
SECURITY TECHNOLOGIES, INC.

ELECTRONIC SECURITY EXPO. SECURITY CONNECTED. ELECTRONIC SECURITY EXPO. SECURITY CONNECTED.

Anti-Trust

Neither ESA nor any committee, product group, conference or activity of ESA shall be used for the purpose of bringing about, or attempting to bring about, any understanding or agreement, whether written or oral, formal or informal, express or implied, among competitors with regard to prices, terms or conditions of sale, discounts, distribution, volume of production, territories or customers.

#ESX2023
SECURITY CONNECTED.

COURSE OBJECTIVES:

Understanding Recurring Revenue Financing in Today's Climate

- A framework to understand performance and value creation
- What metrics are most important and what do they tell you
- Educating the lender
- Decision making process of the lender
- Importance of metrics in a lender's credit decision
- Prudent capital structure

MEET THE SPEAKERS



**JOE
THOMPSON**

**SR. VICE PRESIDENT
BARNES ASSOCIATES**



**SPENCER
ROGERS**

**SR. VICE PRESIDENT
BARNES ASSOCIATES**

Financing Today

Investing for growth takes capital

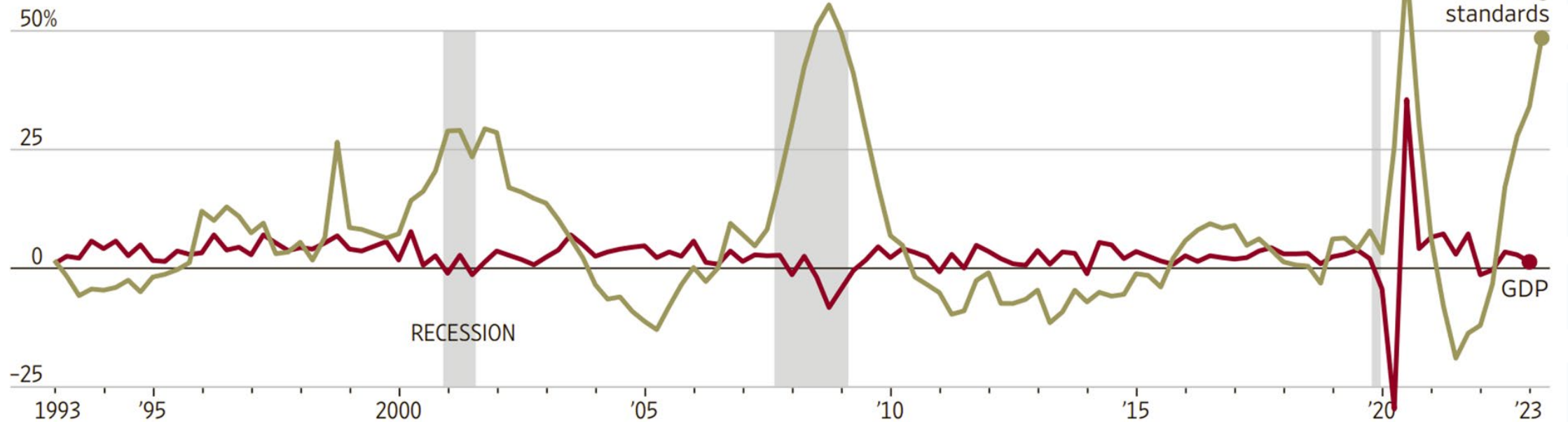
Whether it is new customers through your own sales force, or bulk purchases of accounts through acquisition, you need capital to grow. Faster growth requires more significant capital. Knowing what a capital provider is looking for will help you prepare, especially in this more challenging time.



#ESX2023
SECURITY CONNECTED.

Lending Standards Have Gotten Tighter Lately

U.S. bank lending standards versus change in GDP*



*Percentage of bankers tightening lending standards.

Source: Federal Reserve

From Wall Street Journal, 6/01/23 "Where Is the U.S. Economy Headed? Follow the Money"

#ESX2023
SECURITY CONNECTED.

Understanding Performance and Value Creation

Number 1 Seeds



Does the win/loss record tell you all you need to know?

Super Bowl LVI



#ESX2023
SECURITY CONNECTED.

The Framework

Fundamentally, the industry conducts two distinct activities.



#ESX2023
SECURITY CONNECTED.

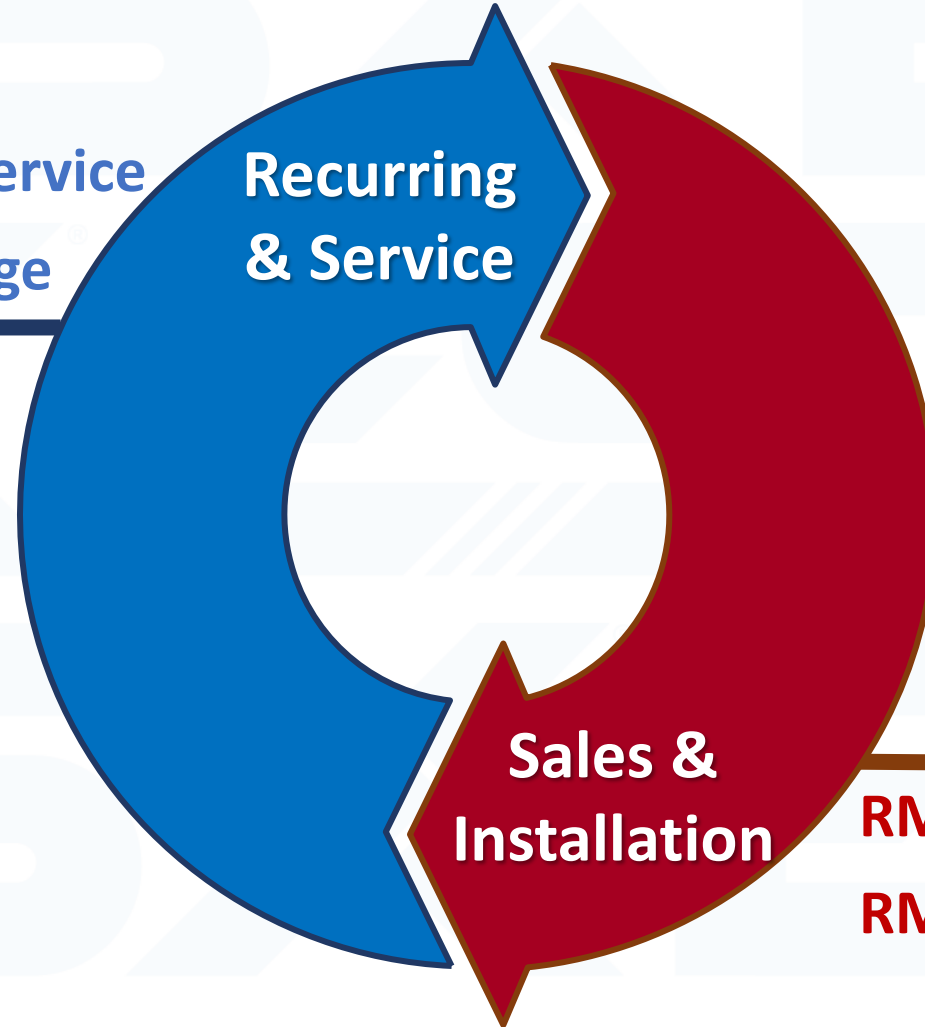
The Framework: Key Metrics

RMR Attrition Rate

Margin on Recurring & Service

Billable Service Percentage

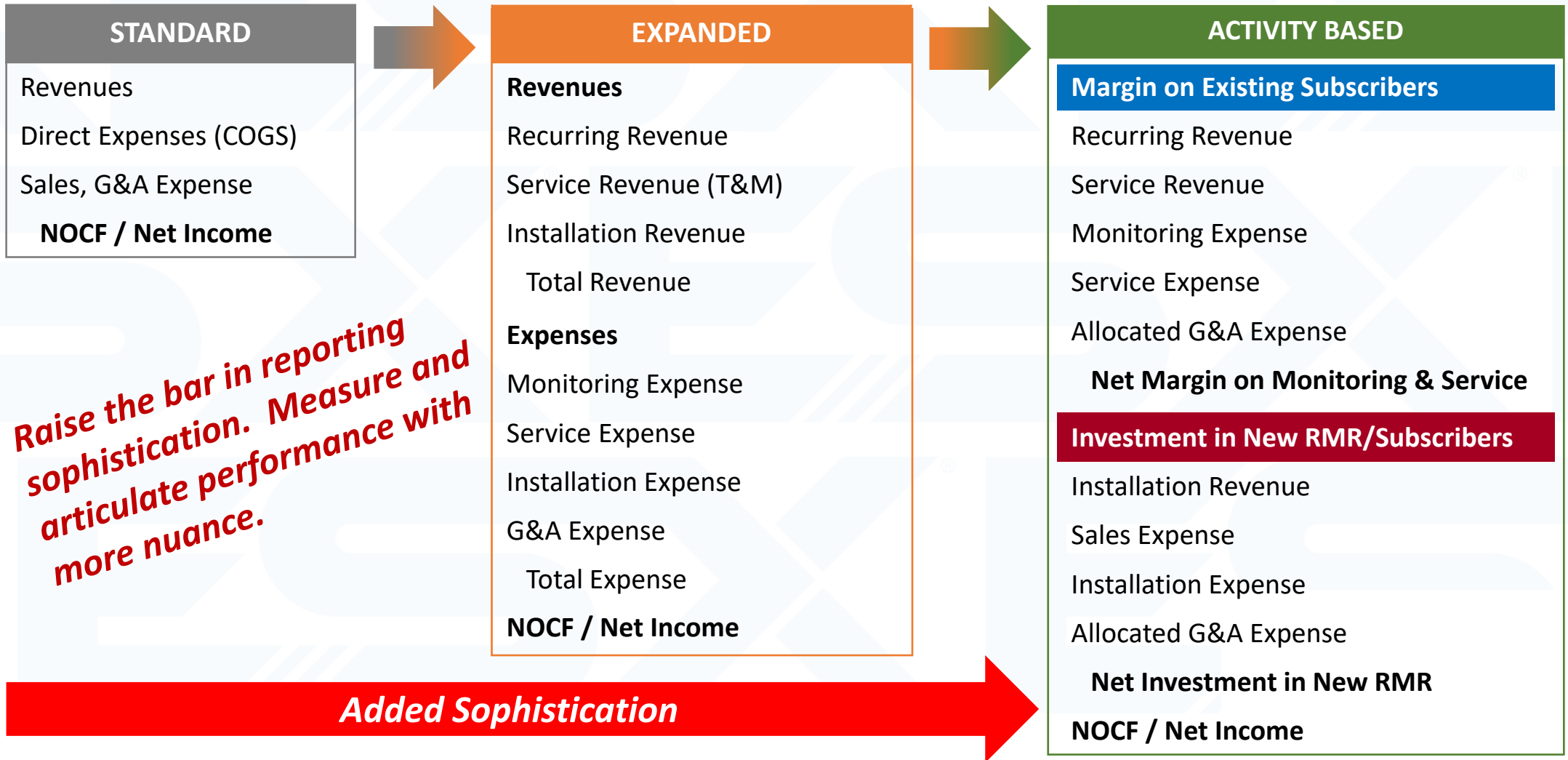
These 5 KPI's can fundamentally tell you how successful you are at each distinct activity.



RMR Creation Multiple

RMR Growth Rate

The Framework: Income Statement

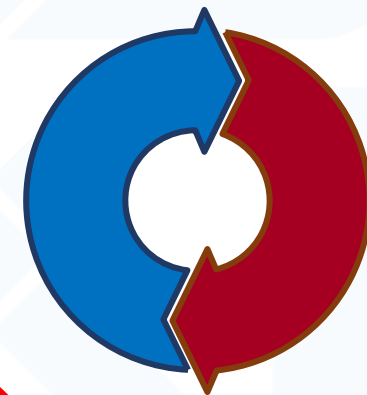


The Framework: Income Statement

STANDARD	
Revenues	\$ 1,950,000
Direct Expenses (COGS)	1,400,000
Sales, G&A Expense	300,000
NOCF / Net Income	\$ 250,000

Cash-based ... don't capitalize costs related to new RMR creation when calculating metrics and talking to your lender.

ACTIVITY BASED	
Margin on Existing Subscribers	
Recurring Revenue	\$ 1,200,000
Service Revenue	150,000
Monitoring Expense	300,000
Service Expense	200,000
<i>Allocated G&A Expense</i>	<i>150,000</i>
Net Margin on Monitoring & Service	\$ 700,000
Investment in New RMR/Subscribers	
Installation Revenue	\$ 600,000
Sales Expense	200,000
Installation Expense	700,000
<i>Allocated G&A Expense</i>	<i>150,000</i>
Net Investment in New RMR	(\$ 450,000)
NOCF / Net Income	\$ 250,000



FULLY BURDENED!
Split G&A 50/50

The Framework: RMR Rollforward

RMR Rollforward	
Beginning of Period RMR	\$ 100,000
New Adds	13,000
Upgrades	1,000
Resigns/Transfers	500
Price Increase	1,000
Cancel	(12,000)
End of Period RMR	\$ 103,500
Gross Attrition Rate	12%
Internal Growth Rate	3%
Price Increase Rate	1%

- Track RMR just like any other asset such as vehicles or inventory. (monthly)
- Account for every \$1 RMR IN and OUT
- Track by “Reason” ...WHY is it coming in and WHY is it going out for both Adds AND Cancels
- Attrition – Always start with the GROSS Attrition Rate
- Automate reporting

#ESX2023
SECURITY CONNECTED.

The Framework: Key Metrics

RMR ROLLFORWARD

Beginning	\$	100,000
Adds		15,500
Deletes		(12,000)
Ending	\$	103,500

Gross Attrition 12%

Internal Growth Rate 3%

OPERATIONS

Cash Flow	Combined	Monitoring & Service	Sales & Installation
Revenue	\$ 1,950,000	\$ 1,350,000	\$ 600,000
Direct Expense	1,400,000	500,000	900,000
G&A	300,000	150,000	150,000
NOCF	\$ 250,000	\$ 700,000	\$ (450,000)

Net Margin 52%

Net Creation Multiple 29x

#ESX2023
SECURITY CONNECTED.

The Framework: Key Metrics and Steady State

RMR ROLLFORWARD

Beginning	\$	100,000		
Adds		15,500	Replace Attrition	\$12,000
Deletes		(12,000)	77%	77%
Ending	\$	103,500		\$3,500
				23%
Gross Attrition		12%		
Internal Growth Rate		3%		

This part of your Sales & Installation activity is "optional".

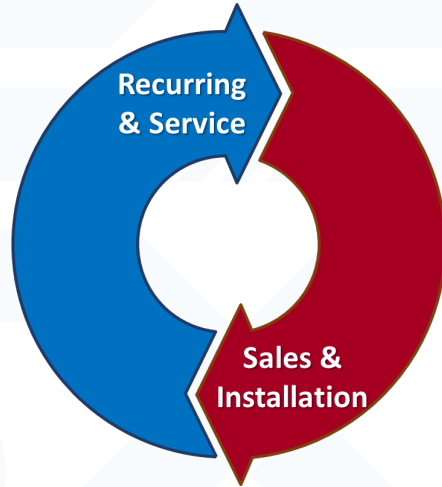
OPERATIONS

Cash Flow	Combined	Sales & Installation		
		Monitoring & Service	Attrition Replacement	Real Growth
Revenue	\$ 1,950,000	\$ 1,350,000	\$ 464,516	\$ 135,484
Direct Expense	1,400,000	500,000	696,774	203,226
G&A	300,000	150,000	116,129	33,871
NOCF	\$ 250,000	\$ 700,000	\$ (348,387)	\$ (101,613)
Net Margin		52%		
Net Creation Multiple			29x	29x
Steady State Net Operating Cash Flow		\$ 351,613		
Run-Rate Adjusted		\$ 376,113		
SSNOCF per \$1 RMR		\$ 3.63		

Demonstrates cashflow capability if you only replaced attrition. ("annuity")

#ESX2023
SECURITY CONNECTED.

The Framework: Key Metrics



Gross Attrition Rate	12%
Net Margin on Recurring & Service	52%
Billable Service Rate	13%

Net Creation Multiple	29x
Internal Growth Rate	3%

Steady State Cash Flow per \$1 RMR	\$3.63
------------------------------------	--------

These metrics provide you the ability to:

- Talk to your lender
- Talk to the market
- Understand value creation
- Benchmark performance against yourself and peers
- Create financial projections/models

#ESX2023
SECURITY CONNECTED.

Educating the Lender



Have your KPI's measured over time

- 24-36 Months
- Show consistency/seasonality



Articulate your company's business and performance

- Markets
- Customer segments
- Products and Services
- Financial projections



Have your financial statements in good order

- Internal financial reports
- External financial reports

#ESX2023
SECURITY CONNECTED.

The Lender's Decision-making Process



Pre-Screen

- High level review of company information



Term Sheet

- Initial indications:
- Commitment Amount
 - Loan Term
 - Interest Rate
 - Borrowing Base
 - Financial Covenants



Due Diligence

- Deep Dive into the borrower:
- Financial
 - Operational
 - Legal



Credit Committee

- Formal approval to lend
- Followed by negotiation of actual loan documents

The importance of cushion: allow room for fluctuations in performance

#ESX2023
SECURITY CONNECTED.

The Importance of Metrics in the Credit Decision

- **Repayment ability:** The most common measure is fixed charge coverage
 - FCCR (Fixed Charge Coverage Ratio) = $OCF \text{ (Operating Cash Flow)} \div FC \text{ (Fixed Charges)}$
 - Example: $1.30x = \$1,040,000 \text{ OCF} \div \$800,000 \text{ FC}$
- **Loan to Value:** A lender wants to keep loan to value conservative
 - $LTV = \text{Total Debt} \div \text{Enterprise Value}$
 - Example: $67\% = \$10,000,000 \text{ Total Debt} \div \$15,000,000 \text{ Enterprise Value}$
- **Operating Trends:** Both direction and consistency of trends are important

#ESX2023
SECURITY CONNECTED.

Prudent capital structure

- **Where debt fits in your capital structure:** Senior debt is usually the least expensive form of capital, but it is also the most restrictive in terms of financial covenants and reporting.
- **Cost of capital vs. availability of capital:** One has to evaluate the explicit cost (i.e. interest rate) as well as the amounts of money you can access from senior debt vs. junior debt vs. equity.
- **Risk:** Not only for the lender, but for you – you have to decide what level of risk you are comfortable taking with a capital provider. Your choice of lender is part of that calculation. Keeping tabs on the lending environment is part of good risk management.

#ESX2023
SECURITY CONNECTED.

Q & A

#ESX2023
SECURITY CONNECTED.

Connect with us on LinkedIn



Joe Thompson
SVP, Barnes Associates



Spencer Rogers
SVP, Barnes Associates



#ESX2023
SECURITY CONNECTED.

RATE THIS SESSION
ESXWEB.COM/FEEDBACK

